

Ask the TIC

Making the NAFTA Work for You

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Trade Information Center

The North American Free Trade Agreement (NAFTA) has created the world's largest free trade area, and it provides important benefits for U.S. goods that are exported to our NAFTA partners, Canada and Mexico. If your product has sufficient North American content to qualify for NAFTA preference, your exports could be subject to a lower duty rate than non-NAFTA goods. Industrial products that qualify under NAFTA will be duty-free between the United States and Mexico by January 1, 2003. Tariffs on other products will be eliminated by 2008. Products traded between Canada and the United States have been duty-free since 1998, with a few exceptions.



WHY SHOULD I QUALIFY MY PRODUCTS FOR NAFTA?

Your firm can take advantage of lower tariff rates on products bound for Canada and Mexico. A lower rate makes your product available at a lower price than your competitors' non-NAFTA goods, without sacrificing your profit margin. Examples of tariff rates on imports into Canada and Mexico of NAFTA and non-NAFTA qualifying products:

Description	U.S. Exports to:	Non-NAFTA Duty Rate	NAFTA Duty Rate
HS 3603.00 Safety fuses	Canada Mexico	7.5% 25%	None None
HS 4810.13 Kaolin-coated paper and paperboard	Canada Mexico	2% 13%	None None
HS 8708.99 Parts and accessories of motor vehicles	Canada Mexico	6% 18%	None None



HOW DO I DETERMINE IF MY PRODUCT IS NAFTA-ORIGINATING?

Goods with sufficient North American content to qualify for NAFTA preferential duty rates are said to "originate" in NAFTA countries. Even if a product is produced or purchased in a NAFTA country, it might not be eligible for preferential tariff treatment because of non-NAFTA inputs in its production. Exporters must therefore analyze the composition of their products. Substantial transformation of non-NAFTA inputs usually must take place to qualify an end product under NAFTA. The NAFTA Rules of Origin describe the amount and type of transformation that must occur.

If your product contains absolutely no non-NAFTA raw materials, inputs, parts, ingredients, or components, it would be considered NAFTA-originating. You may proceed directly to filling out the NAFTA Certificate of Origin, which is the customs document that claims the tariff preference.

For goods containing non-NAFTA inputs or components, exporters must analyze the product-specific Rules of Origin, in Annex 401, Chapter 4 of the NAFTA. Note that your product also meets the NAFTA test if it is made entirely with components or inputs that have already been determined to qualify as NAFTA-originating in accordance with the Rules of Origin. You must always have adequate records relating to your product's inputs, materials, and production to claim NAFTA tariff preference.

Harmonized System (HS) or Schedule B Tariff Numbers

The first step to understanding the NAFTA Annex 401 Rules of Origin is understanding Harmonized System Tariff (HS) numbers. HS numbers are classification numbers assigned to individual products. The NAFTA Annex 401 is organized according to specific HS line items. Exporters must know the HS numbers of the products they wish to export, as well as the HS numbers for the non-NAFTA components or inputs used to make the final goods. HS numbers break down in the following manner:

Chapter:	two digits;
Heading:	four digits;
Subheading:	six digits;
Tariff item:	eight digits;
Statistical break:	10 digits.

For example, for HS 3305.30.0000 (hair spray) the chapter is 33 (perfumery, cosmetic or toilet preparations), the heading 3305 (preparations for use on hair), the subheading 3305.30 (hair lacquers), and so on. Companies can find a searchable database of HS or Schedule B numbers on the U.S. Census Bureau's Web site: www.census.gov/foreign-trade/schedules/b/index.html.

Once a harmonized number is obtained for a final product, an analysis of the Canadian/Mexican most-favored nation (MFN) tariff for the product must be completed. Tariff information is available from a number of sources, including your customs broker, freight forwarder, and the customs authorities of Canada and Mexico. You can also call the Trade Information Center for tariff rates.

If there is no difference between the non-NAFTA (MFN) and NAFTA rates, you do not get a tariff preference—so you do not need to fill out a NAFTA Certificate of Origin. However, there may be other reasons to document North American content (for example, if the

importing NAFTA country imposes anti-dumping duties on similar products from elsewhere, or if your buyers use your products as components in goods they export to NAFTA countries). If the non-NAFTA (MFN) rate is higher, use the HS number to decipher product origination from the NAFTA Annex 401.



HOW DO I READ THE RULES OF ORIGIN?

The following is a simplified analysis of a NAFTA Rule of Origin for the tariff line item for toy electric train sets (9503.10). In the Annex 401, the rule at the subheading level, 9503.10, states: “a change to headings 9503 through 9505 from any other chapter.” This is a rule covering a situation called a “tariff shift.” This rule means that, if the non-NAFTA inputs used to make the electric train set (9503.10) do not fall within HS chapter 95 (toys, etc.), then the end product qualifies for NAFTA preference (i.e., a tariff shift has occurred). For example, a firm may import plastic tape (3919.10) directly from China to manufacture the toy train sets (9503.10) that otherwise contain all NAFTA-originating components. Even though the Chinese plastic tape is used in the manufacturing process, the end product would still qualify, because the non-originating input (plastic tape) does not have the same first two HS numbers (95) as the end product.

Conversely, if we assume that the makers of the electric train sets have imported toy cows from India (classified under HS chapter 95) to be included in the sets, this would disqualify the train sets from obtaining NAFTA preference. In this case, sourcing the toy cows from a NAFTA manufacturer or eliminating it altogether could qualify the train sets.

Once firms have done an analysis of the Rules of Origin, decisions about sources of inputs in a production process can be made to fit the ultimate goal of classifying a product as NAFTA-originating.



WHAT DOES “RVC” MEAN?

In limited cases, the NAFTA Rules of Origin may specify the use of the regional value content (RVC) method of determining if a good can qualify for NAFTA tariff preference. For example, a rule might specify that at least 50 percent of the value of a product must be North American in order to qualify for NAFTA treatment. It is important to note that the regional value content test is not a generally available option for exporters; it may be used only when specified in Annex 401 rules.

Regional value content may be calculated using two methods: transaction value (TV) or net cost (NC). These methods involve

subtracting the value of non-originating materials in a good to arrive at its percentage of North American content. Their difference lies in the cost basis used to make the calculation.

Transaction value generally means the price actually paid or payable for a good, while the net cost means total cost minus sales promotion, marketing and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs that are included in the total cost.

Because the transaction value is a broader basis for calculating content, the regional value content required is higher than for net cost. In most cases where the RVC method can be used, the Rules of Origin will specify the required level of regional value content as 60 percent for transaction value and 50 percent for net cost.

The exact formulas for calculating both methods are found on the Trade Information Center Web site, under NAFTA Rules of Origin: Regional Value Content.

Should precise accounting questions arise regarding RVC, exporters are advised to call a NAFTA specialist at (800) USA-TRAD(E). For complex issues or when interpretation is required, exporters should seek legal assistance or an advanced ruling from the customs administration in the country to which they are exporting.



WHERE CAN I FIND MORE INFORMATION?

Visit the TIC's Web site at www.export.gov/tic and click on “Answers to Your Export Questions.” Two articles written by the TIC for *Export America* on NAFTA, “NAFTA Certificate of Origin: Information and Requirements” and “NAFTA Update: Frequently Asked Questions about the NAFTA,” are located on that page. A downloadable NAFTA Certificate of Origin and links to the Rules of Origin are also provided on the TIC home page under the NAFTA link on the bottom toolbar. Additionally, NAFTA specialists at the Trade Information Center can guide companies through the NAFTA origin certification process. ■

The Trade Information Center (TIC) is operated by the International Trade Administration of the U.S. Department of Commerce for the 19 federal agencies comprising the Trade Promotion Coordinating Committee. These agencies are responsible for managing the U.S. government's export promotion programs and activities. You, too, can “Ask the TIC” by calling (800) USA-TRAD(E) toll free, Monday through Friday, 8:30–5:30 EST. Or visit the TIC's Web site at www.export.gov/tic.